State Spending Cuts Kill Private Sector Jobs and Raise Unemployment

By Stephen Herzenberg and Mark Price • July 19, 2011

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Overview

Pennsylvania's recently enacted 2011-12 budget made substantial cuts in state spending on education, health care, and human services. A new analysis by the Center for American Progress suggests that these cuts could spell bad news for Pennsylvania's economy and jobs outlook in the years ahead.

According to data compiled by the Center, states that cut spending between December 2007 and the end of 2010 experienced greater job loss and increases in unemployment than states that increased spending. In contrast, the 25 states that increased spending over the course of the recession experienced a 0.2 percentage point decrease in the unemployment rate, a 1.4% increase in **private sector** employment and a 0.5% increase in economic growth.

These facts suggest that Pennsylvania's recent state budget cuts could slow down an already fragile economic recovery, impacting businesses and workers in the private sector.

Pennsylvania Cuts State Spending

With the 2011-12 General Fund budget, the Pennsylvania General Assembly and Governor Tom Corbett cut spending from last year's budget by 3.4%. Adjusted for inflation and looking over several years, state budget cuts have been even deeper: a 4% inflation-adjusted decline in spending this year and a 12% decline from the 2008-2009 General Fund budget.[1] The new budget also leaves most of a $786 million revenue surplus untouched and leaves natural gas drillers still free from paying a tax in Pennsylvania that they pay in all other gas-producing states. While a recovery from the recession is well under way, the job market remains weak.

Impact of State Spending on Jobs

Some recent debates about the impact of taxes and spending have taken place in a "fact-free" zone. Anti-tax advocates repeat endlessly that "taxes kill jobs" without offering any evidence that this is true. These debates fail to seriously consider the relative impact of 1) balancing state budgets with spending cuts only versus 2) a balanced approach that combines cuts with some increases in revenues.

Thanks to recent analysis by economist Adam Hersh at the Center for American Progress, we now have some fresh data on the health of the economy in states that cut their budgets in recent years compared

[1] Inflation adjustment is based on the Bureau of Economic Analysis's price index for Gross Domestic Product for state and local expenditures (NIPA Table 1.1.4 Line 25). Spending is adjusted to 2009-Q1 - 2010-Q2 dollars, which is the most recent year of data available.

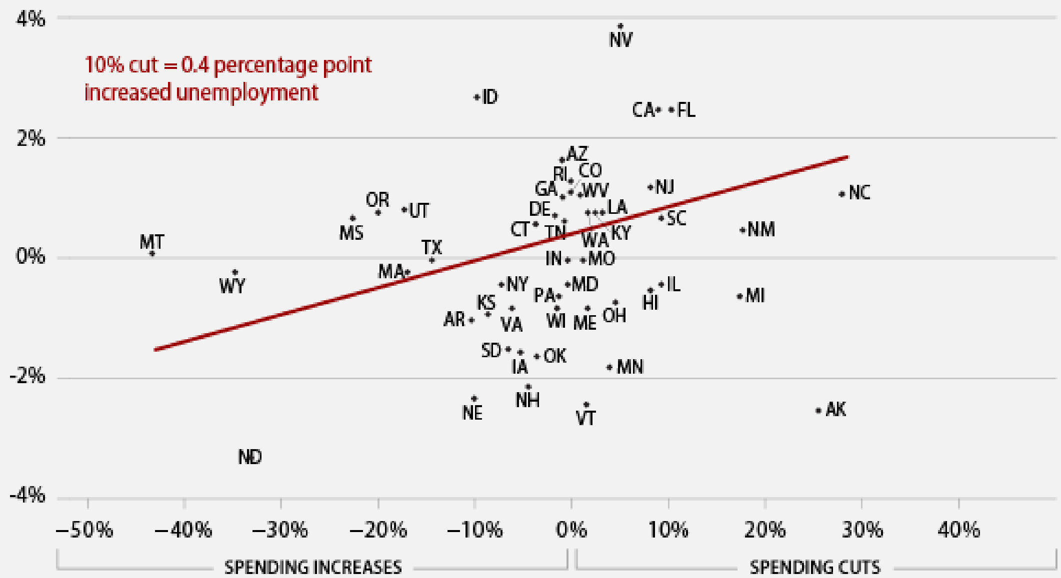
to states that increased spending.[2] Examining inflation-adjusted spending by state from December 2007 through the end of 2010, Hersh found: “Steep state spending cuts have gone hand-in-hand with rising unemployment rates, falling private-sector payroll employment, and lower growth in state’s gross domestic product, or GDP — the sum of all goods and services produced by labor and equipment in each state, less imports.”

Over the three-year period, Hersh finds that, on average, a 10% cut in state spending was associated with a 0.4 percentage point increase in the state unemployment rate (Figure 1).[3]

FIGURE 1

Bigger state spending cuts, more unemployment*

Percentage point change in unemployment rate since recession, difference from national average



Percent cuts in real state government spending since recession

*Population–adjusted. AL excluded due to data problems.
Sources: Adam Hersh, Center for American Progress. Analysis of BLS and NASBO data.

Every 10% cut in state spending was associated with a loss of 1.6% of private-sector jobs in the state (Figure 2).

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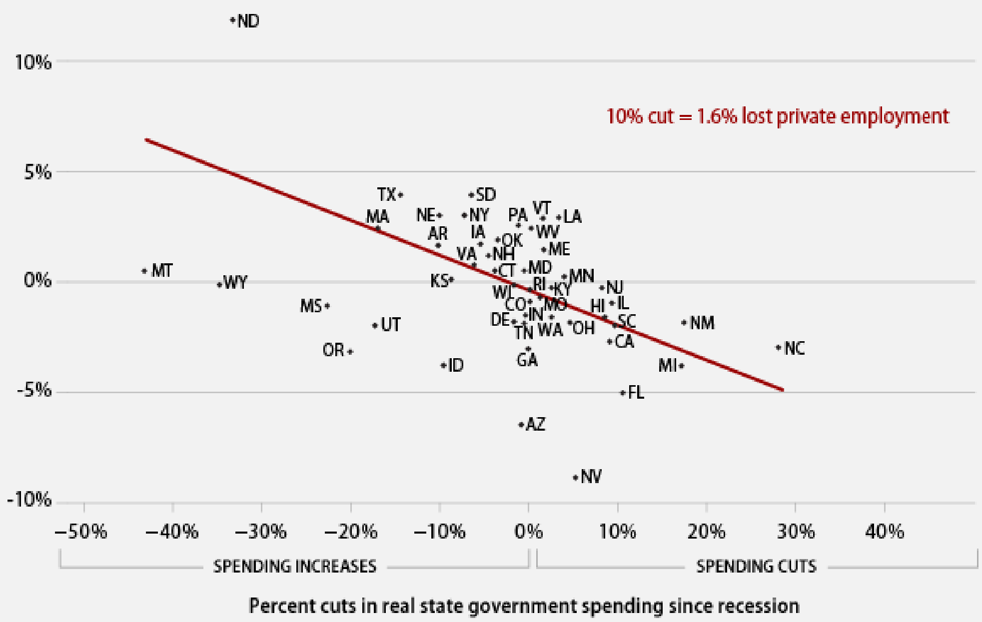
[2] Adam Hersh, Center of American Progress. Analysis available online at http://www.americanprogress.org/issues/2011/06/budget_cuts.html

[3] As Hersh notes, his analysis does not tell us whether spending cuts caused the negative outcomes we observe in the data. These figures only imply a statistical correlation between spending cuts and economic performance. While acknowledging that, basic macroeconomic theory predicts a causal relationship between higher state spending and employment and output. The reason for this is that each dollar of state spending creates more jobs than are eliminated by each dollar in taxes needed to maintain spending. See Peter Orszag and Joseph Stiglitz, *Budget Cuts Vs. Tax Increases At The State Level: Is One More Counter-Productive Than The Other During A Recession?*, http://www.fiscalpolicy.org/10-30-01sfp.pdf.

FIGURE 2

Bigger state spending cuts, bigger employment losses*

Percent change in private employment since recession, difference from national average



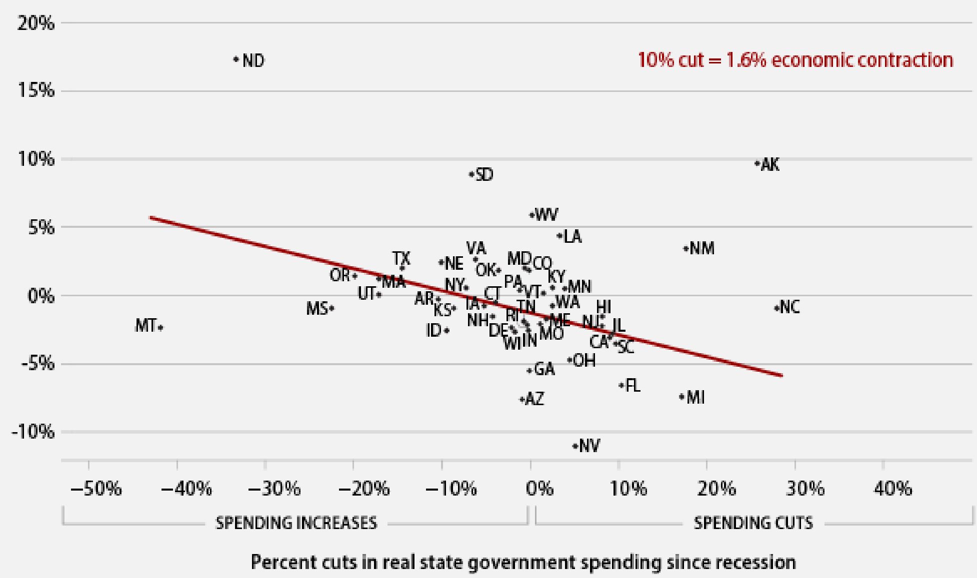
*Population–adjusted. AL excluded due to data problems.
Sources: Adam Hersh, Center for American Progress. Analysis of BLS and NASBO data.

Each 10 percent cut in spending was associated with a 1.6% contraction in real state GDP (Figure 3).

FIGURE 3

Bigger state spending cuts, weaker economies*

Percent change in real state GDP since recession, difference from national average



*Population–adjusted. AL excluded due to data problems.
Sources: Adam Hersh, Center for American Progress. Analysis of BLS and NASBO data.

Pennsylvania Budget Cuts Could Cost 32,000 Jobs

In Pennsylvania, 1.6% of private employment is just under 79,000 jobs.[4] Based on Hersh's analysis, the inflation-adjusted state spending cut for the 2011-12 fiscal year (4%) could translate into a loss of nearly 32,000 jobs.

To put this in perspective, 32,000 jobs is more than three times the number of jobs created by the Marcellus Shale Core Industries since 2007; it is over five-and-a-half times the number of jobs created by Marcellus Shale Core and Ancillary industries.[5]

The bottom line here is that the impact of spending cuts on jobs is not just theoretical — it will substantially impact real workers, real families and real communities. That's what the evidence from other states tells us.

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[4] Total private employment in May 2011 in Pennsylvania was 4,961,300, according to the Pennsylvania Center for Workforce Information and Analysis.

[5] The Pennsylvania Center for Workforce Information and Analysis defines two groups of Marcellus industries within which Marcellus Shale employment is most prominently found: a group of six industries identified as Core Industries and a larger group of industries identified as Ancillary Industries. For more details on the industries that fall within these two categories, see Stephen Herzenberg, "Drilling Deeper into Jobs Claims: The Actual Contribution of Marcellus Shale to Pennsylvania Job Growth," June 20, 2011, http://keystoneresearch.org/publications/research/drilling-deeper-job-claims-actual-contribution-marcellus-shale-pennsylvania-jo.